

This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 03 PRAGUE 000707

SIPDIS

STATE FOR EUR/NCE
COMMERCE FOR 4232/ITA/MAC/MROGERS

E.O. 12958: N/A

TAGS: [PGOV](#) [ECON](#) [EZ](#)

SUBJECT: THE ODS: HOW TO SELL THE DISMANTLING OF THE SOCIAL STATE?

1. Summary: The Czech Civic Democratic Party (ODS) program for the next elections promises a limited state that costs the taxpayer less, but offers less support to citizens and companies and demands they take more responsibility for their own futures. Although the party benefits mightily from the current troubles of the Social Democrats (CSSD), the popularity of its program is important to its electoral chances. Whether the average Czech will easily give up the social benefits the current system still provides, albeit haphazardly and with increasing difficulty, is the question the election will answer. End Summary.

THE CENTER-RIGHT ALTERNATIVE

2. The Civic Democratic Party (ODS) was formed in the early 1990's by members of the citizens' movement Civic Forum which overthrew the Communist government in 1989. Led by Vaclav Klaus, the ODS won the election of 1992 and ruled until 1997, when it lost power due to internal dissension, a series of corruption scandals and an economic recession. The ODS participated in a de facto coalition with the CSSD under the infamous "opposition agreement" from 1998 until 2002. It has been a true opposition party since the 2002 elections. Since 1989, the party has evolved a center-right political ideology under the guidance of Klaus, favoring low taxes, reduced reliance on government transfers and services, and limited regulation. The party maintains close ties with conservative economic think tanks in the United States and considers itself a natural partner of the Republican Party. The ODS currently attracts 33 percent of the electorate in opinion polls, compared to only 12% for the ruling CSSD. It benefits from the voters' disgust with the circus-like atmosphere of the last days of the Gross administration. But for the first time since 1990, it will enter an election, whenever it takes place, without Klaus, its charismatic founder and now the country's ostensibly non-partisan president. To win in 2006, the ODS necessarily will have to rely on its policy prescriptions to carry it the full distance to power, beyond the CSSD's unpopularity.

IT'S IN THE BOOK

3. The ODS is waiting for the slow self-destruction of the current Social Democratic Party (CSSD)-led government to result in elections. Sooner or later, formation of a new government will give its officials not only their eagerly sought prestige and power, but also a chance to realize the party's goals for the Czech Republic. The ODS has spelled out its vision for the Czech Republic in its "Blue Book", published in December 2004. The Blue Book consists of 260 pages of policy formulations that would, if implemented, largely dismantle the socialist state that successive ODS and CSSD governments have both reformed and preserved since 1989. The questions for the ODS are how much the average Czech voter actually knows about its aims, and whether "swing" voters will support a party whose policies openly encourage more self-reliance in terms of government services, pensions and health care.

TOWARD A CHEAPER STATE

4. The "basic icons" of the ODS program, according to its chairman, Miroslav Topolánek, are "inviolable privacy, a cheaper state, a future free of debt and solidarity of responsible persons (with society)." An ODS government will seek "savings through necessary societal and economic changes" and prides itself on being a bulwark against the Communist party, aggressive socialist thinking, and "social engineering, an ever-growing state and the suffocating of individual's activity and freedom." The party wants to increase the motivation to work and to employ, and promises "zero tolerance" for any steps that increase the influence of the state, redistribution of incomes, growth of bureaucracy and corruption. The main changes the ODS seeks in the Czech system are simpler and lower taxes, a cheaper and more efficient bureaucracy, and social reforms that will support the neediest, but free others to choose what, if anything, they will receive from the state in return for what payment.

15. In the area of public finances, the ODS shadow minister of finance, Vlastimil Tlustý, takes credit for the last balanced state budget in 1998, just before the CSSD took office after six years of ODS government. If asked to name a feature of the ODS program, the one thing the average voter could name is the flat, 15% tax on personal and corporate incomes. This would also be the unified rate of VAT, if the ODS has its way. Beyond that, however, the ODS promises elimination of investment incentives, that mainly involve tax holidays for major investments, both foreign and domestic. The ODS desire is to provide across the board tax relief and systematic support for investment that would be available to all companies. Expenditures would be limited to a fixed percent of GDP, and government accounting would be consolidated, eliminating off-budget funds such as those for transportation and housing.

16. Other actions that would have an effect on government finances are deregulation of all prices, including rents, applying a cost/benefit analysis to rule-making, a reduction in the number of parliamentarians and consolidation of some ministries, and replacement of today's welfare system with a negative income tax for low-income persons. Besides a flat tax, the ODS plans a "flat pension" (similar to what is in force in Ireland and Britain) for younger workers, while leaving the current pay-as-you-go system untouched (except for a later retirement age) for older workers. The flat pension means a low single benefit for all payers in return for a lower tax payment, with freedom to increase personal savings to achieve a higher overall retirement benefit. Savings from lower tax payments could be invested in bank accounts, stocks, or even self-employment.

17. In place of today's comprehensive health insurance, now a state requirement, the ODS would establish a required minimum insurance covering the most serious illnesses and injuries. Broader coverage would be a choice of the individual. Part of the system would be a source of information about available services and prices. Payments to encourage childbirth would be halted, relying upon improved educational, employment and housing opportunities to encourage larger families.

HANDS OFF BUSINESS. AND NO HANDOUTS EITHER -----

18. The ODS shadow minister for Industry and Trade, Martin Ríman, promises a number of changes intended to improve the climate for doing business. Businessmen rate high taxes as the chief impediment to business success, and the 15% flat tax would address that complaint. Otherwise, the ODS rejects any formal industrial or export policy in favor of a secure environment for property rights. The state will interfere less in business, but on the other hand, companies will not be able to rely on government support, either. The parliament will transpose only the minimum of European Union legislation required. In the labor market, the ODS will authorize more freedom of contract, including use of part-time and temporary labor. It will do away with the minimum wage. Detailed regulations of the nature of work would be repealed, while focusing the law on protection against excesses and violations of human rights. The Competition Office in Brno will become less a tool of the state to control companies and more of a defender of companies against state interference. Utilities would be regulated to increase, not reduce competition.

19. An ODS government would sell off the remaining few state-owned companies, as much to get government bureaucrats out of doing business in the real economy as to generate government income. It would go on from there to privatize many government services -- public transport, health care, schools, social services, cultural venues, and prisons, for example.

110. The ODS's attitude toward foreign investment is that the state has no role to decide the kind and place of investment, and then to give it above-standard treatment. More important in its view are transparent and enforceable laws, a low level of regulation, low taxes and a flexible labor market. It would eliminate the current system of investment incentives and keep only non-tax incentives that can be applied across the board. One goal is to prevent discrimination against Czech companies in access to incentives, which the ODS contends occurs because most Czech investments are too small to qualify. Laws will be reformed to protect ownership rights and ensure a secure environment for them. The Ministry of Industry and Trade will be transformed into (another) defender of business against government interference, and to add an economic dimension to Czech foreign policy. It will have the important role of promoting and defending Czech interests as EU legislation is developed.

111. The functioning of the Czech court system is an important issue to American and other foreign investors. Jiri Pospisil, the shadow Minister of Justice, promises

tougher disciplinary proceedings for judges. An ODS government will create a corps of junior judges who can help reduce case backlogs in certain areas while gaining important experience. The ability of appeals courts to return cases to courts of first instance will be limited. Subpoena powers will be strengthened to ensure the presence of key witnesses at the appointed time. Execution of judgments will be made easier and faster.

READY TO SAY GOODBYE TO THE SOCIAL STATE?

112. The official ODS vision for the post-election period is certainly that of a leaner state which demands more self-reliance than the current post-communist, Social Democratic version. This begs the question of why the ODS did not institute such reforms when it was in power from 1992 to 1997. One reasonable answer is that the ODS was preoccupied with dismantling communism and establishing the basics of a modern market economy and a democratic society, which are now in place and can withstand further liberalization. In the 1990's Vaclav Klaus made the practical judgment that further reforms could not be sustained politically, and it has been true since then that the realities of coalition politics in the Czech Republic discourage radical changes. The ODS ideal of a self-reliant, entrepreneurial Czech in a limited state is not that of any other viable party -- the CSSD, the KDU-CSL ("conservative" in the European, not the American sense of the word), and certainly not the Communists.

113. However, the CSSD and the new Paroubek government have tried to steal the ODS's thunder with their own proposals for reduction of income taxes, within the current framework of a progressive tax system with traditional deductions. All Czech politicians are looking over their shoulders at Slovakia, which has already implemented a 19% flat tax, as well as reforms of its pension and health care systems, and which as a result is beginning to attract increased attention from foreign investors. We recently attended an ODS-sponsored conference in Prague, called to showcase its tax plans. The conference was attended by officials from Estonia, Slovakia, Russia, and other pioneers of the flat tax, all of whom extolled its virtues and praised ODS concepts of limited government and entrepreneurial freedom.

114. To a large extent, implementing the ODS vision as outlined in the Blue Book depends on the kind of mandate the ODS receives in the next elections. It is unlikely that the ODS will manage a 51 percent majority in Parliament. The closer it comes to that goal, the more of a commitment to its program it can demand from a likely coalition partner. In forming a coalition, the ODS will likely make the 15% flat tax an absolute condition, but forcing acceptance of the rest of its program depends on its mandate. The elections, whenever they come, will be a test of two things: how disgusted the electorate is with the meltdown of the CSSD, and how ready the average Czech is to jettison the socialist certainties of the past.

HILLAS